United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

To be argued by
HORACE P. MOULTON

75-7357,9

United States Court of Appeals
FOR THE SECOND CIRCUIT

Nos. 75-7357,9

THE HOME INSURANCE COMPANY,
Plaintiff-Appellee,
against
THE AETNA CASUALTY AND SURETY COMPANY AND DIAMOND SHAMROCK CORPORATION
Defendants-Appellants.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANT DIAMOND SHAMROCK CORPORATION

CADWALADER, WICKERSHAM & TAFT
Attorneys for Defendant-Appellant Diamond Shamrock Corporation
One Wall Street
New York, New York 10005

Of Counsel:
HORACE P. MOULTON
P. JAY FLOCKEN
THOMAS E. MOSELEY

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Preliminary Statement

Appellant Diamond Shamrock Corporation ("Diamond") submits this brief in reply to the brief of appellee Home Insurance Company ("Home").

ARGUMENT

A. The District Court's construction of the batch clause is not the only reasonable one

Diamond agrees with the District Court that "[t]he terms of an insurance policy are to be construed according to the understanding of an average businessman." (131a).

However, "[w]hen the words are, without violence, susceptible to two interpretations, that which will sustain [the insured's] claim and cover the loss must, in preference, be adopted." *Rickerson* v. *Hartford Fire Insurance Co.*, 149 N.Y. 307, 313, 43 N.E. 856, 858 (1896) quoting May on Insurance, § 175.

The batch clause provides that "all . . . damage arising out of one lot of goods or products prepared or acquired by the named insured . . . should be considered as arising out of one occurrence." The undisputed facts are that the two Harrison lots were defective due to mistakes in their production. An accident in the melting and blending of the Vitamin D3 resin rendered each lot inactive. In consequence, the chicken feed lacked the necessary vitamin content and the chickens were damaged. There was no other mishap intervening between the production mistakes at Harrison and the damage to the chickens.

Given these facts and a copy of the batch clause, it is submitted that an ordinary businessman would—or at least could reasonably—say that the damage to the chickens arose out of the defective Harrison lots and that each lot, therefore, constituted one occurrence. This would clearly be consistent with the words "arising out of" as used in the batch clause. It cannot be disputed that the defective Harrison lots were the originating cause of the damage. Both in the dictionary definition and in common parlance, to "arise out of", in this context, means to "originate from" or to "grow out of". See *Westchester Fire Insurance Co.* v. *Continental Insurance Co.*, 126 N.J. Super. 29, 312 A. 2d 664 (1973), *aff'd*, 65 N.J. 152, 319 A. 2d 732 (1974); *Webster's Third International Dictionary* at 117 (1961).

Nonetheless the District Court held and Home here argues that the term "goods or products" as used in the batch clause refers only to goods which Diamond sells to third parties. To reach this conclusion they necessarily

postulate that the Harrison lots were merely "intermediate products" or "ingredients". Since the resins in the form contained in the Harrison lots were undoubtedly "products" in the ordinary sense of the word and indeed were sold in that form to third parties, it seems most unlikely that the ordinary businessman would conclude that the Harrison lots were not Diamond's "goods or products."

Home argues that the damage to the chickens "hardly arose out of the two Harrison lots, for had Diamond detected the defective condition of those lots no 'damage' would have arisen at all." Home's Brief at 6. From this Home reasons that the damage arose only because Diamond sold the four Louisville lots and it therefore must be held to "arise" from those lots. However, it is equally true that if Diamond had discovered the defects in the Harrison lots before the sale of the Louisville lots or if the discovery had been made before Central Soya sold the chicken feed, there would have been no damage. The fact remains that the defective condition of the Harrison lots was not detected before the damage occurred and it was the condition that caused the damage. Moreover, Home's attempt to bolster its argument by language from *Morris Pincoffs Co.* v. *St. Paul Fire & Marine Ins. Co.*, 447 F. 2d 204 (5th Cir. 1971) is wholly inapposite, for had the insurance policy there contained a batch clause there clearly would have been only one occurrence.

Home supports the District Court's conclusion that, absent the batch clause, the standard definition of "occurrence" in the underlying policy would have mandated a separate occurrence for each time a farmer fed his chickens. All parties agree that the batch clause prevents this disquieting result. The batch clause centers on causation and it is only logical to follow the chain to its origin—the Harrison lots where the defects occurred from which the damage resulted. To stop short at the intermediate point of the

sale of the Louisville lots does [illegible]ace to plain language of the batch clause. If the Harrison lots had not been "prepared" by Diamond but had been "acquired" from an outside source, the clause would seem clearly to have dictated a finding of two occurrences. Moreover, it is also most unlikely that the ordinary businessman would consider a lot of the same consistency an "[illegible]ient" if prepared, but a "product" if purchased, by Diamond.

Home's references to the definition of "products hazard" and to several exclusionary clauses found in the underlying policy are not relevant to the construction of the batch clause. Home concludes from these that:

> It is clear from these definitions and exclusions that "products liability for . . . property damage", the term used in the batch clause, means liability of Diamond for damage to a third person's property as a result of the use by such third person of a commodity made and/or distributed by Diamond after that commodity has passed out of Diamond's possession. Home's Brief at 5.

Diamond agrees that this is a reasonably fair statement of its product liability for property damage coverage under the underlying policy. But this does not bear on the question of the number of "occurrences" under the batch clause or anchor the determination of that number to the number of lots sold. Home does not contend that the "products hazard" definition is to be read with the standard "occurrence clause" (absent the batch clause) to equate "occurrence" to the sale of goods or products. Indeed, as we have seen, its position is that there would have been as many occurrences as there were farmers who fed their chickens. It cannot therefore so equate the same definition to the definition of "occurrence" contained in the batch clause which is not part of the standard policy and which, Home maintains, supersedes the standard definition of occurrence.

B. The rule of *contra proferentem* applies in favor of Diamond, the insured

Home and Diamond each maintain that its construction of the batch clause is the only reasonable one. However, if that clause is found to be ambiguous, Diamond has invoked the rule, well settled in New York, that a reasonable interpretation favorable to the insured must be adopted.

Home now claims, however, that it should have the benefit of the rule because it did not originate the inclusion of the batch clause but merely adopted the Aetna underlying policy which contained the clause. In support of its contention, Home mistakenly relies on *London Assurance Corp.* v. *Thompson,* 170 N.Y. 94, 62 N.E. 1066 (1902). That case involved a controversy between an insurer and its reinsurer which controversy turned upon the construction of a policy of reinsurance. The reinsurer did not see the underlying policy. It accepted a description of the risk from the insurer which varied materially from the coverage stated in the insurer's primary policy. This is not a case between insurerers; it is between Diamond, the insured, and Home, the insurer. Home was fully advised of the batch clause before it issued its policy. That clause was not the invention of Diamond. As the record shows (34a-35a; 50a-41a) the batch clause has been long used in the insurance industry. Thus, Home voluntarily accepted the risk of the batch clause with full knowledge that New York law required any ambiguities to be resolved against it.*

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* If analogies to cases between insurers and reinsurers are relevant, *Jackson* v. *St. Paul Fire and Marine Ins. Co.*, 99 N.Y. 124, 1 N.E. 539 (1885) is more nearly in point. There the reinsurer accepted a share in the precise risk insured by the primary insurer. The definition of the property insured was partially inaccurate, a defense which was unsuccessfully advanced by the insurer in a suit by the insured. The Court held the reinsurer liable to the insurer since it had reinsured the insurer's liability under the underlying policy and therefore the finding of liability against the insurer was binding on the reinsurer.

Nor is Home helped by its citation of *Union Ins. Soc. of Canton, Ltd.* v. *William Gluckin & Co.*, 353 F. 2d 946 (2d Cir. 1965). That case stands for the proposition that the rule of *contra proferentem* does not foreclose the use of parol evidence to resolve an ambiguity. The affidavit of Otto Kaufmann, Jr. of Aetna discloses the intention of Aetna and Diamond with respect to the batch clause and the reasons for its inclusion in the underlying policy (50a). Home argues it was not a party to the underlying policy or to the negotiations that preceded it and is therefore not bound by the intent of Diamond and Aetna. However, it offers no other evidence to resolve the ambiguity, if indeed an ambiguity exists. Consequently, it cannot now be heard to contend that there is evidence which resolves the ambiguity and that the rule does not apply or that the question of the rule's application should await a trial.

CONCLUSION

For all of the reasons set forth in Diamond's main brief and reply brief the decision of the District Court should be reversed, the judgment vacated, and the case remanded with a direction either (i) to enter an order granting Diamond's motion for summary judgment or, in the alternative, (ii) to enter an order denying all motions for summary judgment and to conduct such further proceedings as may be appropriate.

Dated: October 14, 1975
New York, New York

Respectfully submitted,

CADWALADER, WICKERSHAM & TAFT,
Attorneys for Defendant-Appellant
Diamond Shamrock Corporation,
One Wall Street,
New York, New York 10005.
Tel. (212) 785-1000

Of Counsel:
HORACE P. MOULTON,
P. JAY FLOCKEN,
THOMAS E. MOSELEY.

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Jo Robert Massey
att for applnt Aetna Casualty & Surety Co

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